

LOS ANGELES COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2009, through June 30, 2013



JOHN CHIANG
California State Controller

May 2014



JOHN CHIANG
California State Controller

May 8, 2014

John Naimo, Acting Auditor-Controller
Los Angeles County
Kenneth Hall of Administration, Room 525
Los Angeles, CA 90012

Dear Mr. Naimo:

The State Controller's Office audited the methods employed by Los Angeles County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2013. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

If you have any questions, please contact Elizabeth Gonzalez, Chief, Local Government Compliance Bureau, at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/mh

cc: Don Knabe, Chairman
Board of Supervisors
Los Angeles County
Kelvin Aikens, Manager
Apportionment Section
Property Tax Division, Los Angeles County
Jody Martin, Principal Consultant
Joint Legislative Budget Committee
Peter Detwiler, Staff Director
Senate Local Government Committee
Elvia Dias, Committee Assistant
Senate Local Government Committee
Dixie Martineau-Petty, Secretary
Assembly Local Government Committee
Gayle Miller, Staff Director
Senate Revenue and Taxation Committee
Oksana Jaffe, Chief Consultant
Assembly Revenue and Taxation Committee
Neil McCormick, Executive Director
California Special Districts Association

Contents

Audit Report

Summary	1
Background.....	1
Objective, Scope, and Methodology	3
Conclusion.....	4
Follow-Up on Prior Audit Findings.....	5
Views of Responsible Officials	5
Restricted Use	5

Attachment—County’s Response to Draft Audit Report

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Los Angeles County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2013.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Additionally, we made the following observation(s):

- The county computed total net administrative costs including vehicle license fee/sales and use tax (VLF/SUT) up to fiscal year (FY) 2011-12. As a result, the administrative pro-rata share costs were computed incorrectly, substantially increasing the amount of proportionate costs to cities. The county removed VLF/SUT from the administrative cost calculation for FY 2012-13 forward.

VLF/SUT is not to be included in the administrative costs computation. We noted that the county is in the process of correcting the disputed amounts. The county must complete the refund of the over-charge back to the cities.

This issue will be kept open for follow-up in the next audit.

- The county's process for calculating and allocating tax equity allocation (TEA) has been accepted in the past; however, a legal challenge in another county has raised the possibility that the TEA may not be in full compliance with the Revenue and Taxation Code.

We noted that the county is in the process of completing calculations to ensure proper computation of the TEA.

This issue will be kept open for follow-up in the next audit.

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local government agencies with a property tax base that would grow as assessed property values increased. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill (AB) 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for FY 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

The property tax revenues that local government agencies receive each fiscal year are based on the amount received in the prior year, plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 base process involved numerous steps, including the transfer of revenues from schools to local agencies (AB 8 shift) and the development of the tax rate area annual tax increment apportionment factors (ATI factors), which determine the amount of property tax revenues to be allocated to each jurisdiction.

The total amount to be allocated to each jurisdiction is then divided by the total amount to be allocated to all entities to determine the AB 8 apportionment factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities, using the revenue amounts established in the prior year. These amounts are adjusted for growth annually, using ATI factors.

Subsequent legislation removed revenues generated by unitary and nonunitary properties, regulated railway companies, and qualified electric properties from the AB 8 process. These revenues are now allocated and apportioned under separate processes.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently allocated and apportioned to schools by the county auditor according to instructions received from the county superintendent of schools or the State Chancellor of Community Colleges.

Revenues generated by the different types of property tax are apportioned and allocated to local agencies and schools using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls maintained primarily by the county assessor. Tax rolls contain an entry for each parcel of land, including the parcel number, the owner's name, and the value. Following are the types of property tax rolls:

- *Secured Roll*—This roll contains property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if necessary, can be sold by the tax collector to satisfy unpaid tax levies.
- *Unsecured Roll*—This roll contains property that, in the opinion of the assessor, does not have sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—This roll contains public utility, railroad, and qualified electric properties, assessed as either unitary or nonunitary property by the State Board of Equalization.
- *Supplemental Roll*—This roll contains property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property taxes, Senate Bill 418 was enacted in 1985 requiring the State Controller to audit the counties' apportionment and allocation methods and report the results to the California State Legislature.

Objective, Scope, and Methodology

Our audit objective was to review the county's apportionment and allocation of property tax revenues to local government agencies and public schools within its jurisdiction to determine whether the county complied with Revenue and Taxation Code requirements.

To meet the objective, we reviewed the county's procedures for apportioning and allocating property tax revenues used by the county auditor and the processes used by the tax collector and the assessor.

We performed the following procedures:

- Conducted tests to determine whether the county correctly apportioned and allocated property tax revenue.
- Interviewed key personnel and reviewed supporting documentation to gain an understanding of the county's property tax apportionment and allocation processes.
- Reviewed apportionment and allocation reports prepared by the county showing the computations used to develop the property tax distribution factors.
- Reviewed tax rate area reports to verify that the annual tax increment was computed properly.
- Reviewed county unitary and operating nonunitary reports and Board of Equalization reports and verified the computations used by the county to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed redevelopment agency (RDA) reports prepared by the county and verified the computations used to develop the project base amount and the tax increment distributed to the RDA.
- Reviewed successor agency Recognized Obligation Payment Schedules and county apportionment and allocation reports addressing the Redevelopment Property Tax Trust fund.
- Reviewed property tax administration cost reports prepared by the county and verified administrative costs associated with procedures used for apportioning and allocating property tax to local government agencies and school districts.
- Reviewed ERAF reports prepared by the county and verified the computations used to determine the shift of property taxes from local agencies to the ERAF and, subsequently, to public schools.

- Reviewed reports and computations prepared by the county to determine any increases in property tax revenues due cities having low or non-existent property tax amounts.

We conducted this performance audit under the authority of Government Code sections 12468 and 12410. We did not audit the county's financial statements. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period of July 1, 2009, through June 30, 2013. Our audit scope was limited to:

- Reviewing operational procedures and significant applicable controls over the apportionment and allocation process;
- Examining selected property tax apportionment and allocation records; and
- Reviewing related property tax revenue data used to determine the apportionment and allocation computation process.

A property tax bill contains the property tax levied at a 1% tax rate pursuant to the requirement of Proposition 13. A bill may also contain special taxes, debt services levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit is concerned with the distribution of the 1% tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow in order to develop appropriate auditing procedures. We did not evaluate the effectiveness of all internal controls.

In addition, we tested transactions used to apportion and allocate property taxes and performed other procedures deemed necessary. This report relates solely to the method used by the county to apportion and allocate property taxes.

Conclusion

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Additionally, we made the following observation(s):

- The county computed total net administrative costs including VLF/SUT up to FY 2011-12. As a result, the administrative pro-rata share costs were computed incorrectly, substantially increasing the amount or proportionate costs to cities. The county removed VLF/SUT from the administrative cost calculation for FY 2012-13 forward.

VLF/SUT is not to be included in the administrative costs computation. We noted that the county is in the process of correcting the disputed amounts. The county must complete the refund of the over-charge back to the cities.

This issue will be kept open for follow-up in the next audit.

- The county's process for calculating and allocating TEA has been accepted in the past; however, a legal challenge in another county has raised the possibility that the TEA may not be in full compliance with the Revenue and Taxation Code.

We noted that the county is in the process of completing calculations to ensure proper computation of the TEA.

This issue will be kept open for follow-up in the subsequent audit.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued December 10, 2010.

Views of Responsible Official

We issued a draft audit report on February 25, 2014. John Naimo, Acting Auditor-Controller, responded by letter dated April 4, 2014 (Attachment), agreeing with the audit results.

Restricted Use

This report is solely for the information and use of Los Angeles County, the California Legislature, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

May 8, 2014

**Attachment—
County's Response to
Draft Audit Report**



JOHN NAIMO
ACTING AUDITOR-CONTROLLER

**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-3873
PHONE: (213) 974-8301 FAX: (213) 626-5427

April 4, 2014

Ms. Elizabeth Gonzalez, Chief
Local Government Compliance Bureau
State Controller's Office, Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

Dear Ms. Gonzalez:

**RE: PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM AUDIT
REPORT FOR JULY 1, 2009 THROUGH JUNE 30, 2013**

In response to Mr. Jeffrey Brownfield's letter dated March 20, 2014, following is the Department of Auditor-Controller's corrective action on the audit observations of the subject matter.

Property Tax Administrative Fee (PTAF) Charges

As noted in your report, the County is working to implement the Supreme Court's decision that requires PTAF charges to be computed without regard to the property tax revenues distributed to cities in lieu of Vehicle License Fees and Sales and Use Tax. In February 2013, the county reimbursed approximately \$33 million to the 47 plaintiff cities for the additional PTAF charges. Some of the cities continue to dispute the statute of limitations and/or the amount of interest owed on the judgment.

We have also made a good faith effort to reach a settlement with the 40 non-plaintiff cities. However, these cities are also disputing the statute of limitations and applicable interest rate. One city has not yet filed a claim. We anticipate the issue to be resolved before the next State Controller's Office (SCO) audit.

Tax Equity Allocation (TEA) Calculation

We are aware of the legal challenge relating to TEA in the other county mentioned in the audit report and we will ensure we are in compliance with the California Court of Appeal's decision.

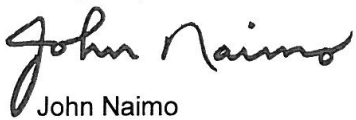
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Ms. Elizabeth Gonzalez
April 4, 2014
Page 2

As noted in your report, the County is in the process of reviewing calculations to ensure proper computation of TEA. We anticipate no observation by the next SCO Audit.

If you have any questions, please contact me or your staff may call Kristina Burns at (213) 974-8362.

Very truly yours,

A handwritten signature in black ink that reads "John Naimo". The signature is written in a cursive, flowing style.

John Naimo
Acting Auditor-Controller

**State Controller's Office
Division of Audits
Post Office Box 942850
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<http://www.sco.ca.gov>